Office Supreme Court, U. S.
FILED
JAN 11 1926
WM. R. STANSBURY
CLERK

No. 168

In the Supreme Court of the United States

October Term, 1925.

GEORGE HARRISON, TRUSTEE IN BANKRUPTCY, OF WESTERN ROPE MANUFACTURING COMPANY, INCORPORATED, BANKRUPT, *Petitioner,*

VERSUS

ANNA B. CHAMBERLIN, *Respondent.*

CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

BRIEF OF RESPONDENT.

HENRY B. MARTIN,
Attorney for Respondent.

INDEX.

PAGE

Statement 1

Propositions 3

Argument 4

A suit by a trustee in bankruptcy against officers of the bankrupt corporation for the conversion of corporate property is not for the recovery of property fraudulently transferred by the bankrupt, and hence not justiciable in a court of bankruptcy under the bankrupt act of July 1, 1898 (30 Stat. L. 544, Chap. 541; Comp. Stat., 1913, Sec. 9585), sections 23b, 70e, where the import of the allegations of the bill is not that the corporation has done anything, but that certain of its officers by false pretenses have withdrawn its funds.. 4

The trustee of a bankrupt corporation cannot recover against the officers of a predecessor of such corporation on account of the misuse of the property of such predecessor when it was solvent and owed no debts, and at a time when the bankrupt corporation was not in existence and could have owed no debts.... 4

A case where a person acted as an officer of a corporation and came into possession of some of its property under claim of right, and another person dealt with such officer receiving said property regards it as his own, invests it in real property, afterwards selling the same and reinvesting the property at a profit covering adverse, continuous and notorious possession of the property for years, is not a case for the summary process of a court of bankruptcy..... 12

The undisputed evidence in the case contradicts the finding and conclusion of the master and of the District Court that the respondent's title to the funds in question was not good..... 18

AUTHORITIES CITED.

PAGES

American Fruit Product Co. v. *Ward*, 99 N. Y. Sup. 717..22
Bardes v. *Bank*, 178 U. S. 524, 44 L. ed. 1175.....18
Central Mfg. Co. v. *Montgomery*, (Mo.) 129 S. W. 460..23
City Electric & Street Railway Co. v. *First National Exchange Bank*, (Ark.) 31 L. R. A. 535.....20
Davis v. *Willey*, (Cal.) 263 Fed. 588.....14
Drew v. *Meyers*, 116 N. W. 871.....18
First National Bank v. *Title & Trust Co.*, 198 U. S. 280, 49 L. ed. 1051.....18
Flanders v. *Coleman*, 250 U. S. 223, 63 L. ed. 948.....16
Fletcher, Cyclopedia Corporations, Vol. 6, Sec. 3735.....5
4 Fletcher, Cyc. Corp., Secs. 2793 and 4047.....20
Graham v. *Lacrosse & Milwaukee R. R. Co.*, 102 U. S. 148, 26 L. ed. 106.....5
Hamilton v. *Menominee Falls Quarry Co.*, (Wis.) 81 N. W. 876.....9
Hollins v. *Brierfield, Coal & Iron Co.*, 150 U. S. 371, 37 L. ed. 1113.....7
In re Interocean Transp. Co. of America, (N. Y.) 232 Fed. 408.....14
Jordut v. *Reuter Hub & Spoke Co.*, (Mo.) 87 S. W. 29..23
Kaigler v. *Gibson, et al.*, (Ga.) 264 Fed. 240.....15
Linn & Lane Timber Company v. *United States*, 236 U. S. 574, 59 L. ed. 725.....23
Louisville Trust Company v. *Comingor*, 184 U. S. 18, 22 Sup. Ct. 293, 46 L. ed. 413.....18
Murphy v. *John Hofman Company*, 211 U. S. 562, 29 Sup. Ct. 154, 53 L. ed. 327.....18
Nix v. *Miller*, (Colo.) 57 Pac. 1084.....6, 7
Norma Mining Co. v. *Mackay*, 241 Fed. 640.....23
Ratcliff v. *Clendenin*, 232 Fed. 61.....10
2 Thompson on Corporations, Secs. 1637 and 1853.....20
Union Banking Co. v. *Truscott Boat Mfg. Co.*, (Mich.) 155 N. W. 716.....18
Watts v. *Gordon*, (Tenn.) 153 S. W. 483.....23
Wheeler v. *Abilene National Bank Building Company*, 159 Fed. 391 (8th Cir.).....23
Whitney v. *Wenman*, 198 U. S. 539, 25 Sup. Ct. 778, 49 L. ed. 1183.....18

IN THE SUPREME COURT OF THE UNITED STATES.

October Term, 1925.

No. 168.

GEORGE HARRISON, TRUSTEE IN BANKRUPTCY, OF WESTERN ROPE MANUFACTURING COMPANY, INCORPORATED, BANKRUPT, *Petitioner,*

vs.

ANNA B. CHAMBERLIN, *Respondent.*

CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

BRIEF *of* RESPONDENT.

Statement.

The statement of the case in petitioner's brief is incomplete and therefore misleading. The funds in question appear by all the evidence to have been, on September 18, 1917, the time when they were received by Mrs. Leftwitch, the property of the Western Rope and Cordage Company, the Western Rope and Manufacturing Company, the bankrupt, having no interest therein. The Western Rope and Cordage Company was not only solvent at the time but owed no debts except current bills which were paid every month and owed none of the claims proved against the

Western Rope and Manufacturing Company, the bankrupt. Ben Gessel and Mrs. Leftwitch owned all of the stock of the Western Rope and Cordage Company and ran the bussiness together. They paid no dividends but used the money of the company as their personal funds (R. 168-169). The transfer of the property of the Western Rope and Cordage Company to the bankrupt, which occurred later in September, 1917, did not include any indebtedness of either Ben Bessel or Mrs. Leftwitch to the company, but was charged off on the books before the transfer (R. 186).

The Master found that Agnes C. Leftwitch, afterwards Agnes Gessel, while an officer of the Western Rope and Cordage Company, withdrew fraudulently and without authority from the funds of said company, the sum of $9,500.00 and placed it to the credit of herself and the respondent in a bank at Broken Arrow. That said $9,500.00 was used by the respondent to purchase a farm near Broken Arrow which she afterwards sold for $13,000.00 and invested $10,000.00 thereof in securities which she later sold for $10,000.00 in currency, and that amount is now in her possession (R. 15).

The only conflict in the evidence was as to whether Mrs. Gessel wrongfully or rightfully received from the corporation these funds, and if wrongfully, whether Mrs. Chamberlin, the respondent, had notice of the fraud.

The points upon which the respondent relies are:

I.

A suit by a trustee in bankruptcy against officers of the bankrupt corporation for the conversion of corporate property is not for the recovery of property fraudulently transferred by the bankrupt, and hence not justiciable in a court of bankruptcy under the bankrupt act of July 1, 1898 (30 Stat. L. 544, Chap. 541; Comp. Stat., 1913, Sec. 9585), sections 23b, 70e, where the import of the allegations of the bill is not that the corporation has done anything, but that certain of its officers by false pretenses have withdrawn its funds.

II.

The trustee of a bankrupt corporation cannot recover against the officers of a predecessor of such corporation on account of the misuse of the property of such predecessor when it was solvent and owed no debts, and at a time when the bankrupt corporation was not in existence and could have owed no debts.

III.

A case where a person acted as an officer of a corporation and came into possession of some of its property under claim of right, and another person dealt with such officer receiving said property regards it as his own, invests it in real property, afterwards selling the same and reinvesting the property at a profit covering adverse, continuous and notorious possession of the property for years, is not a case for the summary process of a court of bankruptcy.

IV.

The undisputed evidence in the case contradicts the finding and conclusion of the master and of the District Court that the respondent's title to the funds in question was not good.

ARGUMENT.

Point I.

A suit by a trustee in bankruptcy against officers of the bankrupt corporation for the conversion of corporate property is not for the recovery of property fraudulently transferred by the bankrupt, and hence not justiciable in a court of bankruptcy under the bankrupt act of July 1, 1898 (30 Stat. L. 544, Chap. 541; Comp. Stat., 1913, Sec. 9585, sections 23b, 70e, where the import of the allegations of the bill is not that the corporation has done anything, but that certain of its officers by false pretenses have withdrawn its funds.

In *Parks, Trustee,* v. *Cameron,* 237 U. S. 616, 59 L. ed. 1147, an attempt was made to recover funds of the bankrupt company fraudulently and without authority misapplied by its directors and general manager. The case is clearly distinguished from that class of cases in which courts of bankruptcy have jurisdiction to avoid fraudulent transfers of the bankrupt's property. The case, on its facts and principles, is analogous to this case upon that point and appears to us to be controlling of the question.

Point II.

The trustee of a bankrupt corporation cannot recover against the officers of a predecessor of such corporation on account of the misuse of the property of such predecessor when it was solvent and owed no debts, and at a time when the bankrupt corporation was not in existence and could have owed no debts.

The leading case on the subject of the rights of subsequent creditors to question previous transactions of a

debtor is *Graham* v. *LaCrosse & Milwaukee R. R. Co.*, 102 U. S. 148, 26 L. ed. 106, wherein the court in an opinion by Mr. Justice BRADLEY, said:

"The main question is, whether the sale to Nash, made before the railroad company became indebted to the appellants, and when for all that appears it was perfectly solvent, even though made for the use and benefit of the officers referred to, can be set aside at the instance of the complainants, for the purpose of subjecting the lands to sale under their execution. And this question, we think, must be answered in the negative.

"It is a well settled rule of law, that if an individual, being solvent at the time, without any actual intent to defraud creditors, dispose of property, for an inadequate consideration, or even make a voluntary conveyance of it, subsequent creditors cannot question the transaction. They are not injured. They gave credit to the debtor in the status which he had, after the voluntary conveyance was made.

"The authorities on this subject are fully collected in the notes to *Sexton* v. *Wheaton*, 1 Am. L. Cas. (8 Wheat. 29), and in the opinion of Chief Justice MARSHALL in that case; and the general doctrine is affirmed in the case of *Mattingly* v. *Nye*, 8 Wall. 370 (75 U. S. XIX, 380).

"* * * But it is contended that this is a case in which the debtor corporation was defrauded of its property, and that as the company had a right of proceeding for its recovery, any of its judgment and execution creditors have an equal right; that it is a property right, and one that inures to the benefit of creditors.

"Conceding that creditors who were such when the fraudulent procurement of the debtor's property occurred—and cases to that effect have been cited—

the question still remains, whether, the debtor being unwilling to disturb the transaction, subsequent creditors have such an interest that they can reach the property for the satisfaction of their debts. We doubt whether any case, going as far as this, can be found. No such case has been cited in the argument. *Dicta* of judges to that effect may, undoubtedly, be produced, but they are not supported by the facts of the cases under consideration."

Fletcher, Cyclopedia Corporations, Volume 6, section 3735, page 6216:

> "*Right of creditors as affected by time when they became such.* According to some courts a recovery may be had for the benefit of creditors regardless of whether they became such before or after the dividends were declared, at least unless those whose claims accrue subsequently know that the dividend has been paid out of capital. Other courts, however, have held that a corporation, if solvent, has a right to declare a dividend as against subsequent creditors, and therefore creditors who become such after the payment of a dividend cannot recover the same from the stockholders on the subsequent insolvency of the company, but that its assets must first be appropriated to the payment of its existing debts before any portion of them can be distributed to the stockholders, and creditors who become such before the payment of dividends may recover the same from the stockholders where such payment renders the corporation insolvent. The burden of proving that the creditors for whose benefit a recovery is sought became such before the payment was made is on the plaintiff, where his allegation that such was the case is denied."

In *Nix* v. *Miller*, (Colo.) 57 Pac. 1084, the court announced the following rule:

"It is held by the highest authority in this county (*Graham* v. *Railroad Co.*, 102 U. S. 148), that the disposal by a corporation of any of its property cannot be questioned by any of its subsequent creditors. Other authorities might be cited, but this case is controlling. It is upon the ground that the diversion of funds occurred before the plaintiff became a creditor that appellant seeks to escape liability. If the facts of the case at bar brought it within the principle of the authority cited, we would not hesitate to recognize the rule therein announced, because not only is it a sound one, but, in the absence of a controlling rule in our own jurisdiction (of which there is none), we would be inclined to follow the decision of the august tribunal from which it emanated."

In *Hollins* v. *Brierfield Coal & Iron Co.*, 150 U. S. 371, 37 L. ed. 1113, this question was presented to the court, and in an opinion by Mr. Justice BREWER, the court announced the following rule:

"While it is true language has been frequently used to the effect that the assets of a corporation are a trust fund held by a corporation for the benefit of creditors, this has not been to convey the idea that there is a direct and express trust attached to the property. As said in 2 Pomeroy's Equity Jurisprudence, Sec. 1046, they 'are not in any true and complete sense trusts, and can only be called so by way of analogy or metaphor.'

"To the same effect are decisions of this court. The case of *Graham* v. *LaCrosse & M. R. Co.*, 102 U. S. 148 (26106), was an action by a subsequent creditor to subject certain property alleged to have been wrongfully conveyed by the corporation debtor, to the satisfaction of his judgment. And the very proposition here presented was then considered, and in respect

to it, the court, by Mr. Justice BRADLEY, said (page 160):

> 'It is contended, however, by the appellant that a corporation debtor does not stand on the same footing as an individual debtor; that, whilst the latter, has supreme dominion over his own property, a corporation is a mere trustee, holding its property for the benefit of its stockholders and creditors; and that if it fail to pursue its rights against third persons, whether arising out of fraud or otherwise, it is a breach of trust, and creditors may come into equity to compel an enforcement of the corporate duty. This, as we understand, is the substance of the position taken.
>
> 'We do not concur in this view. It is at war with the notions which we derive from the English law with regard to the nature of corporate bodies. A corporation is a distinct entity. Its affairs are necessarily managed by officers and agents, it is true; but, in law, it is as distinct a being as an individual is, and is entitled to hold property (if not contrary to its charter) as absolutely as an individual can hold it. Its estate is the same, its interest is the same, its possession is the same. Its stockholders may call the officers to account, and may prevent any malversation of funds, or fraudulent disposal of property on their part. But that is done in the exercise of their corporate rights, not adverse to the corporate interests, but coincident with them.'

"Solvent, it holds its property as any individual holds his, free from the touch of a creditor who has acquired no lien; free also from the touch of a stockholder who, though equitably interested in, has no legal right to the property. Becoming insolvent, the equitable interest of the stockholders in the property, together with their conditional liability to the creditors,

place the property in a condition of trust, first, for the creditors, and then for the stockholders. Whatever of trust there is arises from the peculiar and diverse equitable rights of the stockholders as against the corporation in its property and their conditional liability to its creditors. It is rather a trust in the administration of the assets after possession by a court of equity than a trust attaching to the property, as such, for the direct benefit of either creditor or stockholder."

Hamilton v. *Menominee Falls Quarry Co.*, (Wis.) 81 N. W. 876:

"It is now settled in this state, as the result of a series of decisions, that the directors of a going corporation are in no sense trustees for the corporate creditors in the management of the corporate business, even though the corporation be insolvent; and that it is only when the corporation ceases to be a going concern, or the situation is such that its directors know, or ought to know, that suspension is impending, that its assets become a trust fund, so that directors may not prefer themselves over general creditors (*Hinz* v. *Van Dusen*, 95 Wis. 503, 70 N. W. 657); and, further, that when the corporation is solvent, and there is no actual intent to defraud creditors, it may dispose of property for an inadequate consideraion, or by voluntary conveyance, as an individual may do, and subsequent creditors cannot question the transaction (*Shoemaker* v. *Lumber Co.*, 97 Wis. 585, 73 N. W. 333; *Graham* v. *Railroad Co.*, 102 U. S. 148, 26 L. ed. 106). This last proposition is founded upon very plain principles of justice and reason. A simple creditor has no interest in or lien upon the corporate property. If, after a corporation has conveyed a part of its property with no fraudulent intent, but for an inadequate consideration, there still remains ample corporate property to pay debts, then no existing creditor can com-

plain, for he has not been damnified; and, if this is true as to present existing creditors, it is necessarily and more clearly true as to subsequent creditors, who have not relied upon the conveyed property for security, or contracted with reference thereto."

In *Ratcliff* v. *Clendenin*, 232 Fed. 61, this court considering the identical proposition herein presented, in an opinion by Mr. Justice SANBORN said:

"This was a suit in equity by the trustee in bankruptcy of the Elevator Company to recover this $4,500.00 of Ratcliff, a stockholder, in the right of creditors of the corporation who held claims against the corporation which were incurred before that $4,500.00 was paid out, on the theory that this $4,500.00 was money of the insolvent corporation which was held by its officers in trust for its creditors when it was paid to Ratcliff, and that Ratcliff knew this fact and procured the payment of this money to him without giving any consideration therefor. Facts essential to this cause of action which the trustee pleaded were, *first*, that there were creditors of the Elevator Company represented by the trustee who held claims allowed against the estate of the bankrupt which were incurred by the corporation before at least some of this $4,500.00 was paid over to Ratcliff, for creditors having claims which accrued after those payments have no equity in any of this $4,500.00 superior to the equity of Ratcliff. *Hamilton* v. *Menominee Falls Quarry Co.*, 106 Wis. 352, 81 N. W. 876, 879. But the answer of Ratcliff denied that there were any claims of any creditors which accrued before all of the $4,500.00 was paid over to him by alleging that he had no knowledge or information sufficient to form a belief on that subject. The burden, therefore, was on the plaintiff to prove its averment of this essential fact and it made no proof thereof whatever. In the *second* place, the trustee

averred that the Elevator Company was insolvent when this $4,500.00 was paid, and that this money was a fund held in trust for the creditors of the corporation; that Ratcliff knew this fact and obtained the money without any consideration. Ratcliff denied these averments in his answer, and the burden was on the plaintiff to prove them, and there is no substantial proof of any of them.

"* * * As the plaintiff failed to prove that the Elevator Company was insolvent when the $4,500.00 was paid to Ratcliff, it failed to establish the fact that that sum or any part of it was ever charged with any enforceable trust or equitable lien in favor of any creditor of the corporation, or in favor of the trustee in bankruptcy. A solvent corporation, like a solvent individual, holds its property free from any enforceable trust or equitable lien in favor of its creditors. It is only when it becomes insolvent that such a trust or lien in favor, first of its creditors, and second of its stockholders, attaches to its property. *Hollins* v. *Brierfield Coal & Iron Co.*, 150 U. S. 371, 383, 385, 14 Sup. Ct. 127, 37 L. ed. 1113; *McDonald* v. *Williams*, 174 U. S. 397, 403, 19 Sup. Ct. 743, 43 L. ed. 1022; *Larence* v. *Greenup*, 97 Fed. 906, 908, 909, 38 C. C. A. 546, 549; *Great Western Mining & Mfg. Co.* v. *Harris*, 128 Fed. 321, 331, 63 C. C. A. 51, 61; *New Hampshire Sav. Bank* v. *Richey*, 121 Fed. 956, 961, 58 C. C. A. 294, 298. So it was that the plaintiff failed to prove any of the essential elements of the cause of action he pleaded, and the record discloses no equity in his favor which entitles him to recover of the defendant.

"Counsel for the trustee, however, argue that there was no formal declaration of a dividend, that no other stockholders had an income like that of the defendant paid to him on his investment, that section 1741 of the General Statutes of Kansas of 1909, provides that the directors of a corporation shall 'declare and

make such dividends of the profits from the business of the corporation as they shall deem expedient, or as the by-laws may prescribe,' that this is in legal effect to prohibit and the general law of the community forbids the payment of dividends out of capital, that the capital of the Elevator Company was impaired when the payments were made to Ratcliff, that there were no profits, and that for these reasons the payment of the $4,500.00 was unlawful. The answers to this contention are many and conclusive. If the contention stated a cause of action, it was a cause of action that was neither pleaded nor tried in the court below. It does not state a cause of action in favor of any creditor whom the trustee represents, because it fails to plead that any such creditor has any claim which accrued before the $4,500.00 was fully paid, or that the company was insolvent when that payment was made." (Italics ours.)

This case sustains the contention of the respondent, Anna B. Chamberlin, that the petition upon which the order to show cause was issued did not state facts sufficient to constitute a cause of action in favor of said trustee and against said Anna B. Chamberlin. Many other cases could be collected supporting the foregoing rule, but we deem a further continuation of the discussion of this particular question to be unnecessary.

Point III.

A case where a person acted as an officer of a corporation and came into possession of some of its property under claim of right, and another person dealt with such officer receiving said property regards it as his own, invests it in real property, afterwards selling the same and re-

investing the property at a profit covering adverse, continuous and notorious possession of the property for years, is not a case for the summary process of a court of bankruptcy.

The court *In re Rathman*, 183 Fed. 913, in discussing the jurisdiction of the bankruptcy court in summary proceedings, in an opinion by Judge SANBORN, said:

> "If the commencement of bankruptcy proceeding without more, without any act of the bankruptcy court or any of its officers, to give notice to adverse claimants, or to reduce the property claimed to belong to the bankrupt to the possession of the officers of that court as his property, gives it constructive possession, and hence a legal custody that enables it to determine by summary proceedings the merits of adverse claims to liens and titles to such property in the actual possession of others, then no case could ever arise in which any other court could have jurisdiction by plenary suit to determine the merits of such claims, for in every case a bankruptcy proceeding is commenced, and the only ground on which the jurisdiction to determine summarily the merits of such claims is sustained is that the bankruptcy court's legal custody of the property excludes the jurisdiction of every other court and gives it the power to determine summarily all claims to liens upon, or interests in, the property in such custody. But this theory flies in the face of the settled rule repeatedly announced by the Supreme Court that the actual possession by the bankruptcy court is the indispensable condition of its exclusive and of its summary jurisdiction here. In *Bardes* v. *Hawarden Bank*, 178 U. S. 524, 536, 20 Sup. Ct. 1000, 1005 (44 L. ed. 1175), the court held that the clause of section 23 of the bankruptcy law giving jurisdiction of controversies at law or in equity between trustees as such and adverse claimants to the Circuit Courts in

the same manner and to the same extent as though bankruptcy proceedings had not been instituted and such controversies had been between the bankrupt and such adverse claimants 'indicates the intention of Congress that the ascertainment, as between the trustee in bankruptcy and a stranger to the bankruptcy proceedings, of the question whether certain property claimed by the trustee does or does not form part of the estate to be administered in bankruptcy, shall not be brought within the jurisdiction of the national courts solely because the rights of the bankrupt and of his creditors have been transferred to the trustee in bankruptcy'."

In re Interocean Transp. Co. of America, (N. Y.) 232, Fed. 408:

"*Bankruptcy. Jurisdiction of Court. Adverse Claims.* Claims asserted after bankruptcy by third persons to a fund placed by the bankrupt in possession of a custodian having no claim thereto, arising out of transactions before the bankruptcy, are adverse, and the court of bankruptcy is without jurisdiction to determine the same, except by consent."

Davis v. *Willey*, (Cal.) 263 Fed. 588:

"VAN FLEET, District Judge. This is an action at law by a trustee in bankruptcy to recover a certain fund alleged to have been transferred by the bankrupt to his brother in fraud of the rights of his creditors. It is admittedly prosecuted under the authority of section 70e of the Bankruptcy Act (Comp. St., Sec. 9654), which provides that: 'The trustee may avoid any transfer by the bankrupt of his property which any creditor of such bankrupt might have avoided, and may recover the property so transferred, or its value, from the person to whom it was transferred,' etc.

"It is well established that the effect of this section is to clothe the trustee with no new or additional

right in the premises over that possessed by a creditor, but simply puts him in the shoes of the latter, and subject to the same limitations and disabilities that would have beset the creditor in the prosecution of the action on his own behalf; and the rights of the parties are to be determined, not by any provision of the Bankruptcy Act, but by the applicable, principles of the common law, or the laws of the state in which the right of action may arise. In other words, the Bankruptcy Act merely permits the trustee to assert the rights which the creditor could assert but for the pendency of the bankruptcy proceedings, and, if, for any reason arising under the laws of the state, the action could not be maintained by the creditor, the same disability will bar the trustee. Collier on Bankruptcy (10th ed.), 1042, (f) and (g); *In re Mullen*, (D. C.) 101 Fed. 413; *Holbrook* v. *First International Trust Company*, 220 Mass. 150, 107 N. E. 665; *Manning* v. *Evans*, (D. C.) 156 Fed. 106."

Kaigler v. *Gibson, et al.*, (Ga.) 264 Fed. 240:

"Under the pleadings, as well as the proof, Mrs. Gibson was an adverse claimant of the money and automobile in her possession at the time of the bankruptcy and the jurisdiction of a controversy with her over them is fixed by section 23 of the Bankruptcy Act (Comp St., Sec. 9607). By that section the trustee could sue in the federal court only as the bankrupt might have done had bankruptcy not intervened, with two exceptions; *first*, by consent of the defendant, and, *second*, in suits for the recovery of property under sections 60b, 67e, and 70e (Comp. Stat., Sec. 9644, 9651, 9654). There is no diversity of citizenship and no federal question, and the bankrupt could not have maintained suit in a federal court for the property. The trustee must therefore rely for jurisdiction on the exceptions stated."

Flanders v. *Coleman*, 250 U. S. 223, 63 L. ed. 948:

"Whether the District Court has jurisdiction to grant any relief must be determined upon a consideration of the allegations of the bill and the amendment thereto. If there be enough of substance in them to require the court to hear and determine the cause, then jurisdiction should have been entertained. Looking to the allegations of the bill and the amendment, as we have stated them, it appears that the trustee invoked the aid of Sec. 60b of the Bankruptcy Act as amended Feb. 5, 1903 (32 Stat. at L. 709, chap. 487, Comp. Stat. 1916, Sec. 9644, 1 Fed. Stat. Anno., 2nd ed., p. 1026), relating to preferential transfers made within four months before the filing of the petition in bankruptcy; also, Sec. 67e, Act of July 1, 1898 (30 Stat. at L. 564, Chap. 541 Comp. Stat. 1916, Sec. 9651, 1 Fed. Stat. Anno., 2nd ed., p. 1109), making fraudulent transfers within four months null and void, except as to persons acting in good faith, or for a present, fair consideration, and of Sec. 70e of the Act (30 Stat. at L. 566, Chap. 541, Comp. Stat. 1916, Sec. 9654, 1 Fed. Stat. Anno., 2nd ed., p. 1150), providing that the trustee may avoid any transfer of the bankrupt's property that any creditor might have avoided, and may recover the property so transferred, or its value, from the person to whom it was transferred, unless he was a bona fide holder prior to the adjudication.

"Since the amendments to the Bankruptcy Act of Feb. 5, 1903, and June 25, 1910 (32 Stat. at L. 797, Chap. 487, 36 Stat. at L. 838, Chap. 412, Comp. Stat. 1916, Sec. 9586, 1 Fed. Stat. Anno., 2nd ed., p. 528), the District Courts of the United States are given concurrent jurisdiction with the state courts to set aside preferences under Sec. 60b of the act, and fraudulent transfers within four months prior to the filing of the petition under Sec. 67e of the act, and transfers under Sec. 70e, making void any transfer by the bankrupt of

his property which any creditor might have avoided, and giving the trustee the right to recover the same. See *Stellwagen* v. *Clum*, 245 U. S. 605, 614, 62 L. ed. 507, 511, 38 Sup. Ct. Rep. 215; *Collet* v. *Adams*, decided April 28, 1919 (249 U. S. 545, *ante*, 764, 39 Sup. Ct. Rep. 372).

"The opinion of the District Court as set forth in the record, shows that its conclusion, that there was no jurisdiction, was based upon a consideration of the evidence, from which it was found that no preference was shown under Sec. 60b, nor any fraudulent transfer under Secs. 67e or 70e. To justify its conclusion that it was without jurisdiction, the district judge cites certain decisions of this court: *Bardes* v. *First Nat. Bank*, 178 U. S. 524, in which this court held that under Sec. 23 of the Bankruptcy Act the District Court, could by the consent of the defendant, and not otherwise, entertain suits by the trustee against third persons to recover property conveyed by the bankrupt before the institution of the bankruptcy proceedings. It is sufficient to say of that case that it was decided under the terms of the act before the amendments of 1903 and 1910, respectively, to which we have referred, and which give concurrent jurisdiction to the state and federal courts. The District Court also cited *Harris* v. *First Nat. Bank*, 216 U. S. 382, 54 L. ed. 528, wherein no transfer of the bankrupt's property was alleged in the petition. The suit was one by the trustee to recover securities of the bankrupt, alleged to be held by the bank for the security of an overdraft, which it was averred, had been paid; and also to recover certain notes alleged to have been paid by the bankrupt.

"The opinion of the District Court shows that it really considered the merits of the case in reaching the conclusion that it was without jurisdiction. As this court has not infrequently said, jurisdiction must be determined not upon the conclusion on the merits of

the action, but upon consideration of the grounds upon which federal jurisdiction is invoked."

Other cases supporting this rule are:

First National Bank v. *Title & Trust Co.*, 198 U. S. 280, 49 L. ed. 1051;

Louisville Trust Company v. *Comingor*, 184 U. S. 18, 22 Sup. Ct. 293, 46 L. ed. 413;

Murphy v. *John Hofman Company*, 211 U. S. 562, 29 Sup. Ct. 154, 53 L. ed. 327;

Whitney v. *Wenman*, 198 U. S. 539, 25 Sup. Ct. 778, 49 L. ed. 1183;

Bardes v. *Bank*, 178 U. S. 524, 44 L. ed. 1175;

Drew v. *Meyers*, 116 N. W. 781;

Union Banking Co. v. *Truscott Boat Mfg. Co.*, (Mich.) 155 N. W. 716.

Point IV.

The undisputed evidence in the case contradicts the finding and conclusion of the master and of the District Court that the respondent's title to the funds in question was not good.

The evidence discloses that the Western Rope & Cordage Company was incorporated in 1915, by B. M. Gessel and Agnes C. Leftwich, who owned all the capital stock of said company, and conducted the affairs of said company until 1917, when pursuant to a minute of the Western Rope & Manufacturing Company, dated September 24, 1917, the property of said Western Rope & Cordage Company was transferred to said Western Rope & Manufacturing Company in payment of capital stock of said Western Rope & Manufacturing Company, of the value of $150,000.00.

The record shows that prior to the transfer of the property of the Western Rope & Cordage Company to the bankrupt company on September 30, 1917, B. M. Gessel was indebted to said Western Rope & Cordage Company in the sum of $27,647.74, as shown by his account with said company, and that said account of B. M. Gessel included the item of $9,500.00 herein alleged to have been fraudulently withdrawn from the funds of the Western Rope & Manufacturing Company by Agnes C. Leftwich, on September 18, 1917. That prior to said transfer, said account was charged off the books of the Western Rope & Cordage Company as a bad debt, and uncollectible, and did not constitute a part of the assets of said company sold to the Western Rope & Manufacturing Company, in payment of said capital stock.

The record shows that the transaction between said companies was that of sale and purchase, and there is nothing in the record anywhere that would tend to support the first finding of fact of said Special Master.

In the second finding of fact said Special Master found, that said $9,500.00 was fraudulently and without authority withdrawn from the funds of the Western Rope & Cordage Company by Agnes C. Leftwich. The record shows that at the time said Western Rope & Cordage Company was incorporated by said Agnes C. Leftwich and B. M. Gessel, there was transferred to said corporation a business theretofore conducted by B. M. Gessel, and a man by the name of Woodward. That Agnes C. Leftwich paid into said corporation the sum of $3,600.00. From the date of the incorporation of said company up to and including September 30, 1917, when the property of the same was sold and transferred to the Western Rope & Manufacturing

Company, said company was prosperous and wholly solvent. Agnes C. Leftwich and B. M. Gessel, as owners of all the capital stock of said company, had exclusive and absolute control of the affairs of said company.

The record further shows that although said company conducted a large and important business, and that its profits for the year 1917 were approximately $195,000.00, no dividends were ever declared. Money was withdrawn from said company from time to time for the use of both Agnes C. Leftwich and B. M. Gessel, who were at that time engaged, which engagement resulted in their marriage on November 30, 1920.

On the date said sum was withdrawn the same was charged to the personal account of B. M. Gessel, and also entered in the journal and cash book of said company. There was no concealment, and if said Western Rope & Cordage Company were attempting to recover said funds said entries in its books would be conclusive evidence against it of notice of said transhaction.

City Electric & Street Railway Co. v. *First National Exchange Bank*, (Ark.) 31 L. R. A. 535:

> "The entries upon the books of the corporation are *prima facie* evidence against it as admissions. The records and books of the corporation become conclusive evidence against it when they are books and records of the corporation, and entries upon them have been duly made by the recording officers."
>
> —4 Fletcher, Cyc Corp., Secs. 2793 and 4047;
>
> 2 Thompson on Corporations, Sec. 1637, p. 726, and Sec. 1853, p. 923.

There is a conflict in the testimony as to whether or not B. M. Gessel actually knew of said transaction at the

time. He admits, however, that monthly statements of his account with said company, showing the items charged and credited to said account were prepared for his information. That he did not recall discussing the item of $9,500.00 with Agnes C. Leftwich, but that if she had asked him for anything he would not have refused her.

The entire capital stock of said company being owned by B. M. Gessel and Agnes C. Leftwich, and the company being wholly solvent, the withdrawal of said funds by Agnes C. Leftwich under the facts as disclosed by the evidence in the record could not under any possible theory be fraudulent as to subsequent creditors on whose behalf this proceeding is prosecuted.

The conclusions of law of said Special Master, set out in said report, to the effect that equitable title to said sum of $9,500.00 never passed out of the Western Rope & Cordage Company; that the Western Rope & Manufacturing Company succeeded to the title thereto, until the appointment of a trustee when the same vested in him, and that the claim of Anna B. Chamberlin to said fund was based on fraud, and only colorable, and not real, and that said fund was an asset of the bankrupt estate, and subject to summary jurisdiction of the bankruptcy court, are not sustained by the evidence, and are contrary to the law and the evidence. There is no evidence in the record that Anna B. Chamberlin had any information concerning the source from which her daughter, Agnes C. Leftwich, obtained said fund, except the testimony of said Anna B. Chamberlin. She testified that her daughter, Agnes C. Leftwich, was indebted to her, and that it was her understanding that her daughter was making money in the business in which she was associated with B. M. Gessel.

The record shows that the owners of the entire capital stock of the Western Rope & Cordage Company either had actual knowledge of said transaction, and at the time consented thereto, or notice thereof was obtained within a short time thereafter by reason of the entries in the books of said company. It affirmatively appears from the record that the item of $9,500.00 charged to the account of B. M. Gessel with the Western Rope & Cordage Company, was never transferred to the Western Rope & Manufacturing Company. This being true, title to said item did not vest in said trustee upon his appointment, and qualification.

Since it is admitted in the record that the respondent, Anna B. Chamberlin, had retained said fund and the proceeds thereof in her possession, using it as she saw fit, and claiming it as her own, at all times since September 18, 1917, under the rule announced by the decisions herein cited, the same is not subject to the summary jurisdiction of the bankruptcy court.

The *American Fruit Product Co.* v. *Ward*, 99 N. Y. Sup. 717, was an action wherein the plaintiff sought to recover for breach of contract.

An option was given to plaintiff covering all of the assets of the corporation, which option the plaintiff elected to exercise. Among other things the question of the ownership of a certain horse was involved in this action. All the capital stock of said corporation was owned by the defendant and members of his family, and prior to the execution of said option the horse in question had been bought by the defendant with funds of the corporation, and given to a daughter of the defendant.

The court held that there was no reason why the funds of the corporation could not be used for this purpose since

all the capital stock of the corporation was owned by the defendant, and members of his family, and all the stockholders consented to said transaction.

—*Watts* v. *Gordon*, (Tenn.) 153 S. W. 483;

Jordut v. *Reuter Hub & Spoke Co.*, (Mo.) 87 S. W. 29;

Central Mfg. Co. v. *Montgomery*, (Mo.) 129 S. W. 460;

Norma Mining Co. v. *Mackay*, 241 Fed. 640;

Linn & Lane Timber Company v. *United States*, 236 U. S. 574, 59 L. ed. 725;

Wheeler v. *Abilene National Bank Building Company*, 159 Fed. 391 (8th Cir.).

The foregoing decisions clearly establish the proposition that persons owning the entire capital stock of a corporation are in legal effect the corporation, and that transactions of such persons dealing with the affairs of the corporation are binding upon the corporation.

The final judgment entered in said cause overruling the exceptions of the respondent, Anna B. Chamberlin, to the report of said Special Master, finding the facts in favor of said trustee, and against said respondent, Anna B. Chamberlin, finding that Anna B. Chamberlin had in her possession the sum of $10,000.00 without color of title, and in fraud of the rights of the Trustee in Bankruptcy, and that said sum was an asset of said bankrupt estate, and ordering and directing said respondent, Anna B. Chamberlin, to forthwith deliver said sum to said George Harrison, Trustee, is not sustained by the evidence, on the findings of fact set out in the report of said Special Master and is contrary to law.

It appears from the report of said Special Master that the respondent, Anna B. Chamberlin, appeared specially, and objected to the jurisdiction of the bankruptcy court to make her a party to said proceedings, and to said summary proceedings, at all hearings before said Special Master.

The only controverted fact in the record is as to the circumstances under which said sum of $9,500.00 was withdrawn from the funds of the Western Rope & Cordage Company. All the evidence establishes that said fund was withdrawn on the 18th day of September, 1917. That on said date all the capital stock of said Western Rope & Cordage Company was owned by Agnes C. Leftwich and B. M. Gessel; that said company was solvent, and owed no debts except current bills. That its profits for the year, 1917, were approximately $195,000.00. That no dividends were ever declared, and paid out of the funds of said corporation since its organization in 1915. That on the date said fund was withdrawn the same was charged to the personal account of B. M. Gessel with said company; also entered in the journal and cash book of said company. That monthly statements showing the items charged and credited to the account of B. M. Gessel with said company were furnished to him for his information.

The record further shows that Agnes C. Leftwich and B. M. Gessel, were on said date said fund was withdrawn engaged in building up the business of said company, for their mutual benefit, they being on said date engaged, and were thereafter on November 30, 1920, married. That Agnes C. Leftwich was indebted to her mother, Anna B. Chamberlin, and deposited said sum of $9,500.00 to their joint credit in the First National Bank of Broken Arrow, Oklahoma. That the sum of $9,500.00 was withdrawn from

said joint account by said Anna. B. Chamberlin, and used in the purchase of a farm near Broken Arrow, Oklahoma, on October 2, 1917. That thereafter, on March 23, 1920, said farm was sold for the sum of $13,000.00, $10,000.00 of which was used to purchase certain real estate mortgages from the Exchange Trust Company of Tulsa, Oklahoma, and thereafter said mortgages were transferred and assigned to the Liberty National Bank of Tulsa, Oklahoma, for the sum of $10,000.00, which sum was in possession of said Anna B. Chamberlin on the date of the last hearing before said Special Master.

The record further shows that the Western Rope & Manufacturing Company, was incorporated in September, 1917. That on September 24, 1917, an entry was made in the minute book of said Western Rope & Manufacturing Company, reciting the acceptance of the transfer submitted by the Western Rope & Cordage Company, and authorizing and directing said secretary to purchase the property of the Western Rope & Cordage Company, as set forth in their proposal and in payment therefor to issue certificates of stock in the Western Rope & Manufacturing Company to the amount of $150,000.00.

That on September 30, 1917, and prior to the transfer of the property of the Western Rope & Cordage Company, to the Western Rope & Manufacturing Company, the account of B. M. Gessel with the Western Rope & Cordage Company amounting to the sum of $27,647.74, and including said item of $9,500.00, charged to said account on September 18, 1917, was charged off the books of the Western Rope & Cordage Company as a bad debt, and uncollectible, and treated as such in the income tax report of said company for said year.

Under the foregoing admitted facts the possession of said Anna B. Chamberlain of said fund could not be without color of title, and in fraud of the rights of the Trustee in Bankruptcy.

Under the decisions hereinbefore cited the Western Rope & Cordage Company would be bound by the transaction by which said funds were withdrawn, and since said company was solvent at the time, and none of the creditors represented by said Trustee in Bankruptcy were creditors of the Western Rope & Cordage Company at the time said funds were withdrawn, the court could not possibly find that said fund constituted an asset of the bankrupt's estate.

By reason of the foregoing facts and the further fact that the motion of the trustee to make additional parties on which the order purporting to make the respondent, Anna B. Chamberlin, a party to said bankruptcy proceeding was made did not state jurisdictional facts, which question was timely raised by objection thereto, said order was without jurisdiction and void. The petition of the trustee upon which the order to show cause issued did not state facts sufficient to constitute a cause of action in favor of said trustee, and against the respondent, Anna B. Chamberlin, for the reasons hereinbefore set out. The final decree, ordering and directing respondent, Anna B. Chamberlin, to forthwith deliver to George Harrison, Trustee of the Western Rope & Manufacturing Co., the sum of $10,000, is without jurisdiction, erroneous and void, said Anna B. Chamberlin not having at any time consented and submitted to the jurisdiction of the bankruptcy court to adjudicate said matter, and having at all times objected to the exercise of said jurisdiction by said court.

We respectfully submit that the opinion and judgment of the Circuit Court of Appeals is right and that the writ in this case should be dismissed.

Respectfully submitted,

HENRY B. MARTIN,
Counsel for Respondent.